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C O N F I D E N T I A L SECTION 01 OF 02 TBILISI 000529

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TAGS: [ECON](#) [ENRG](#) [PGOV](#) [PREL](#) [RU](#) [GG](#)  
SUBJECT: GEORGIA: GOG TAKES OVER KAZTRANSغاز, OVERWHELMING  
DEBTS MEAN BANKRUPTCY LIKELY

Classified By: Ambassador John F. Tefft for reasons 1.4 (b) and (d).

¶1. (C) Summary. On March 16, the Georgian National Electricity Regulatory Commission (GNERC) announced it had appointed a special administrator<sup>8</sup> to manage KazTransGaz-Tbilisi, the Kazakhstani company that owns the Tbilisi natural gas distribution system. KazTransGaz is owned by the Kazakhstani state company KazMunaiGaz. Deputy General Director Mamuka Kikalashvili confirmed that the company is now under Georgian Government management, due to over USD 167 million in unpaid debt, of which USD 40.4 million is to the Georgian Oil and Gas Company (GOGC). While some media has speculated that Russian pressure could be behind the Kazakhstani state company refusing to pay outstanding debts, Kikalashvili insists that the state of the company is due to the failure of the Kazakhstani management and not political pressure. Kikalashvili does not expect KazTransGaz to pay its outstanding liabilities, and therefore believes the company will eventually go into bankruptcy hearings and be sold by the government. End summary.

BEST OF INTENTIONS, BUT GAS CAN'T GO THROUGH RUSSIA

¶2. (C) KazTransGaz purchased the Tbilisi gas distribution system in 2006 for USD 12 million, an apparent good deal. However, given technical and commercial losses in distribution, the company ended up using over USD 100 million in investment money to fund the purchase of gas. Deputy General Director Kikalashvili said that during 2006 and 2007 the debt continued to grow, and no one in KazTransGaz or KazMuniGaz appeared to be paying attention. When he was hired in 2008 to help turn the company around, Kikalashvili pointed out that debts already totaled more than USD 100 million. He said Kazakhstani management appeared to be surprised by these figures, had no idea where the money had gone, and was now refusing to invest in company operations. While he said in the past year commercial losses have dropped more than 20 percent, it has not been nearly enough to recoup corporate losses, a problem compounded by regulation that compels gas distributors to account for commercial losses at USD 280 per TCM. Initially KazTransGaz purchased the Tbilisi gas distribution network with the intent of transiting its own gas, which the state-owned company could buy cheaply, through Russia and selling it at a mark up in Georgia. Unfortunately, soon after the purchase was made, the Russians essentially shanghaied the deal by refusing to allow transit.

GOG TAKES OVER MANAGEMENT AFTER FAILURE TO SELL

¶3. (C) The GNERC has appointed Temur Kopaliani, a GOGC employee, as special administrator for the company. According to Kikalashvili, Kopaliani is already in place and appears to be competent. He said that as a first measure many members of Kazakhstani management are being removed. All non-management jobs appear safe while the government completes its review. Kikalashvili said that he does not

expect KazTransGaz to pay the outstanding debt, and stressed that the company had been trying to sell the Tbilisi distribution system for some time, but with limited success. He said that while KazMuniGaz had had discussions with SOCAR (Azerbaijani) and Kala Capital (Georgian) on purchasing KazTransGaz-Tbilisi the asking price was astronomical. When KazMuniGas finally dropped the price due to the global financial crisis, interested companies wanted it to go even lower. Kikalashvili expects that KazTransGaz-Tbilisi will be forced to declare bankruptcy and the government will then auction off the company cheaply, likely for no more than USD 80 million. He expects Kala Capital to be the eventual buyer.

OUTSTANDING DEBTS TOTAL USD 167 MILLION

14. (C) In addition to the USD 40.4 million KazTransGaz owes GOGC, it must also repay USD 10.3 million to the Bank of Georgia and USD 50 million to Credit Suisse. The company also has USD 9.7 million in outstanding debt to Georgian contractors, and USD 57 million to KazMuniGaz. If bankruptcy is declared and the company sold, clearly the outstanding debt to GOGC will be the first paid, with Georgia banks likely next. Given its daughter company's default, it is unlikely that KazMuniGaz will be repaid any of the USD 57 million.

15. (C) Comment: While many in Tbilisi are speculating that Russian pressure might have convinced the Kazakhstani state company to withhold payment to the Georgian government, reviewing the economics of the situation it appears that poor management is the real culprit. However, the Russian refusal to allow cheap gas from Kazakhstan to transit Russia for sale

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in Georgia did scuttle Kazakhstan's money-making plans. Politics aside, it is easy to see why GazProm would have turned down the Kazakhstani request, as cheap gas from Kazakhstan would quickly become an attractive competitor to GazProm's higher priced gas. The Tbilisi gas distribution system is incredibly difficult to manage, especially as much of the infrastructure is dated and inefficient. With bills for technical and commercial bill, plus losses from theft, totaling more than 40 percent of the value of gas purchased in 2006 and 2007, it is easy to see how a company not paying close attention could quickly find itself in serious debt. It is interesting, however, that despite KazTransGaz's refusal to pay GOGC for gas, it continues to pay 100 percent of its bills to SOCAR. While in the last year KazTransGaz-Tbilisi decreased losses to 20 percent, it was too little too late. Despite the apparent failure of the company, it appears that the Government is committed to ensuring that gas service will continue un-interrupted to the population of Tbilisi.

TEFFT